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Russian Federation: high GDP growth and rising investment

The Russian GDP grew by nearly 7% in 2003 – significantly more than most forecasters (including wiiw) had expected. Last year's GDP growth turned out to be the second highest in Russia's recent economic history (topped only by the 10% growth rate in the year 2000); since the 1998 financial crisis the GDP has expanded by more than 35%. Higher world market energy prices resulted in a resumption of net export growth; there was also a marked increase in investments. Both private consumption and real household incomes continue to expand as well. With the government budget in a sizeable surplus, foreign exchange reserves at a record level, a slightly appreciating exchange rate and a modest decline in both inflation and unemployment, the Russian economy is now in its best shape since the beginning of transition.

Export revenues were up by more than 25% in USD terms compared to a year earlier, largely thanks to higher energy revenues (crude oil, products and gas make up 55% of the total). Imports increased by more than 20%, partly also due to price and exchange rate effects. The foreign trade surplus exceeded EUR 50 billion and the current account surplus reached 9% of GDP. The growth of export revenues will most likely bottom out this year while imports, fuelled by strong consumer and investment demand, will continue to grow. Though the trade and current account surpluses will remain large, their contribution to GDP growth will diminish. The main pillar of growth in the current year of presidential elections will be private consumption, yet investment is expected to increase moderately as well. In 2005, lower growth of consumption is likely while investment may accelerate again. However, we do not expect any marked upturn in FDI inflows (in 2003 there was a net outflow of FDI from Russia) as the investment climate – especially for foreigners – will stay rough. The recent attacks on the 'oligarchs' may even discourage the return of flight capital.

Last year's investment recovery can be explained by several factors, both internal (domestic) and external. First, favourable prices have facilitated high revenues and profits in the Russian energy and metals sectors (and revenues of the state budget) which together account for about two thirds of total investment. Second, the global economic weakness, low interest rates and depressed yields on international bond and stock markets have made investments in Russia more attractive. The inflow of foreign direct investment was up by about 50% in the first half of 2003 while Russian investments abroad (and the capital flight) have diminished. These encouraging developments have stopped, or even reversed, during the past months, partly as a

reaction to the Yukos affair and pre-election rhetoric. For the medium- and long-term outlook it will be crucial not only to restore investors' confidence, but also to diversify investment flows from extracting to manufacturing industries.

Despite the largely positive economic indicators, a sustainable development is still uncertain considering the lagging implementation of administrative reforms, legal regulations and, last but not least, growing structural distortions in the economy. The new Russian parliament (Duma) is dominated by pro-Putin forces; his victory in the March 2004 presidential elections is certain. Political stability is thus guaranteed, but the speed (and in particular the efficiency) of the reform process is not. Neither the recent murky affairs related to privatization deals (Yukos, Gazprom, Novoye Vremya) nor the announcement to form a 'Common Economic Space' together with Belarus, Kazakhstan and Ukraine are likely to have a significant economic impact on Russia. Despite the recent favourable developments, wiiw expects that Russian GDP growth will drop below 5% in 2004 since no additional growth stimulus can be identified. There is a broad consensus that the current pace of economic growth is not sustainable in the medium- and long-run unless the pace of structural, institutional and banking sector reforms increases substantially. This may well be the case after President Putin's re-election, yet not earlier than 2005.

Table RU

Russia: Selected Economic Indicators

	1997	1998	1999	2000	2001	2002	2003 ¹⁾	2004 forecast	2005 forecast
Population, th pers., end of period	147105	146693	145925	145185	144317	143467	143500	143000	142700
Gross domestic product, RUB bn, nom.	2342.5	2629.6	4823.2	7305.6	8943.6	10834.2	13300	15300	17200
annual change in % (real)	1.4	-5.3	6.4	10.0	5.1	4.7	6.8	4.5	4.1
GDP/capita (EUR at exchange rate)	2431	1618	1256	1928	2365	2540	2680	2820	2940
GDP/capita (EUR at PPP - wiiw)	5220	5050	5460	6130	6630	7160	7830	8300	8860
Gross industrial production									
annual change in % (real)	1.9	-5.2	11.0	11.9	4.9	3.7	7.0	5	4
Gross agricultural production									
annual change in % (real)	1.5	-13.2	4.1	7.7	7.5	1.7	1.5	.	.
Goods transport, bn t-kms	3256	3147	3315	3480	3755	3976	4269	.	.
annual change in %	-3.4	-3.3	5.3	5.0	7.9	5.9	7.4	.	.
Gross fixed investment, RUB bn, nom.	408.8	407.1	670.4	1165.2	1504.5	1758.7	2183.3	.	.
annual change in % (real)	-5.0	-12.0	5.3	17.7	8.7	2.6	12.5	9	9
Construction output total									
annual change in % (real)	-6.0	-5.0	6.0	17.0	9.9	2.7	14.4	.	.
Dwellings completed, th units	430.3	387.7	389.8	373.4	381.6	396.4	423.2	.	.
annual change in %	-10.6	-9.9	0.5	-4.2	2.2	3.9	6.8	.	.
Employment total, th pers., average	64693	63812	63963	64327	64710	65650	65482 ^{I-XI}	.	.
annual change in %	-1.9	-1.4	0.2	0.6	0.6	1.5	-0.9 ^{I-XI}	.	.
Employment in industry, th pers., average	14905	14162	14297	14543	14692	14768	.	.	.
annual change in %	-8.9	-5.0	1.0	1.7	1.0	0.5	.	.	.
Reg. unemployed, th pers, end of period	1998.7	1929.0	1263.4	1037.0	1122.7	1500.0	1638.0	.	.
Reg. unemployment rate in %, end of period	2.7	2.7	1.7	1.4	1.6	2.1	2.3	.	.
LFS - unemployment rate in %, average ²⁾	12.0	13.5	13.0	10.5	9.1	8.0	8.5	8	9
Average gross monthly wages, RUB	950.2	1051.5	1522.6	2223.4	3240.4	4360.0	5512.0	.	.
annual change in % (real, gross)	4.7	-13.3	-22.0	20.9	19.9	16.2	10.4	.	.
Retail trade turnover, RUB bn	883.3	1078.7	1855.9	2430.4	3176.3	3898.1	4483.5	.	.
annual change in % (real)	4.7	-3.3	-6.1	9.0	10.8	9.0	8.0	.	.
Consumer prices, % p.a.	14.8	27.6	85.7	20.8	21.6	16.0	13.6	10	8
Producer prices in industry, % p.a.	15.0	7.1	58.9	46.6	19.1	11.8	15.6	12	10
Central government budget, RUB bn									
Revenues	343.4	325.9	615.5	1132.1	1590.7	2202.2	2341.9 ^{I-XI}	.	.
Expenditures	436.6	472.2	666.9	1029.2	1325.7	2046.0	2025.8 ^{I-XI}	.	.
Deficit (-) / surplus (+)	-93.2	-146.3	-51.4	102.9	265.0	156.2	316.1 ^{I-XI}	.	.
Deficit (-) / surplus (+), % GDP	-4.0	-5.6	-1.1	1.4	3.0	1.4	.	.	.
Money supply, RUB bn, end of period									
M1, Money	298.3	342.8	526.8	879.3	1192.6	1498.1	1899.0 ^{Nov}	.	.
M2, Money + quasi money	457.2	628.6	984.9	1560.0	2122.7	2842.5	3618.0 ^{Nov}	.	.
Refinancing rate of NB % p.a., end of per.	28	60	55	25	25	21	16	.	.
Current account, EUR mn	-71	192	23100	50619	37729	31217	34600	30000	25000
Current account in % of GDP	0.0	0.1	12.6	18.0	11.0	8.5	9.0	7.5	6.0
Gross reserves of NB, excl. gold, EUR mn	11567	6650	8387	26139	37026	42290	58531	.	.
Gross external debt, EUR mn	117330	161282	177091	173872	171578	146011	138549 ^{Nov}	.	.
Exports total, fob, EUR mn ³⁾	76623	66467	70820	113672	113748	113558	120000	121000	126000
annual change in %	8.3	-13.3	6.5	60.5	0.1	-0.2	6	1	4
Imports total, fob, EUR mn ³⁾	63474	51798	37061	48552	60025	64521	66400	70000	76000
annual change in %	18.2	-18.4	-28.5	31.0	23.6	7.5	3	6	8
Average exchange rate RUB/USD	5.79	9.71	24.62	28.13	29.17	31.35	30.57	32	34
Average exchange rate RUB/EUR (ECU)	6.54	11.06	26.24	26.03	26.13	29.65	34.55	38	41
Purchasing power parity RUB/USD, wiiw	2.78	3.26	5.54	7.47	8.50	9.73	11.02	11.9	12.6
Purchasing power parity RUB/EUR, wiiw	3.05	3.55	6.04	8.19	9.32	10.52	11.83	12.9	13.6

Notes: 1) Preliminary. - 2) In 1998 data refer to October. - 3) Based on balance of payments statistics, including estimate of non-registered trade. Converted from USD to EUR using the ECB EUR/USD foreign exchange reference rate.

Source: wiiw Database incorporating national statistics; wiiw forecasts.